

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact [REDACTED]

Telephone Number [REDACTED]

Refer Reply to [REDACTED]

Date:

AUG 20 1990

RECEIVED

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Form Number: 1041

Tax Years: All

Accounting Period Ending: June 30

APR 2 1991

District Director Of Internal Revenue  
CHIEF, TECHNICAL STAFF  
BALTIMORE

Dear Applicant:

This is a final adverse ruling as to your exempt status under section 501(c)(9) of the Internal Revenue Code.

Our adverse ruling of [REDACTED], was based on two grounds. The first ground was set forth on Page 5, Paragraph 2 of that ruling, as follows:

We note that while medical benefits and life insurance benefits are provided on an identical basis to employees of both [REDACTED] and the adopting employers, there are other benefits which are available only to the management employees of the sponsoring company. These include dental benefits and short term disability benefits. These restrictions on benefits to the management group, many of whom are prohibited group members, contravenes the anti-discrimination rules set forth in section 1.501(c)(9)-2(a)(2)i) of the regulations. The payment of disproportionate benefits to management employees by the Trust, without an objective and nondiscriminatory basis, also contravenes the requirements of section 1.501(c)(9)-4(b). The result is that such payments are not made for qualifying benefits within the meaning of Code section 501(c)(9).

The second ground for denial of exemption under Code section 501(c)(9) was set forth on Page 7, third full paragraph, as follows:

With respect to your own application, the adopting employers span at least [REDACTED] states, in different regions of the country. While all the sponsoring employers are involved in the hotel business, they are not necessarily affiliated

[REDACTED]

by [REDACTED]. Thus, the requirement for an employment-related common bond among participating individuals is not satisfied because the sponsoring employers are not located in the same geographic locale. See section 1.501(c)(9)-2(a)(1) of the regulations and the underlying history of the "same geographic locale" requirement, as discussed above. While the continued need for this particular requirement is under study by the Service, it remains in effect until such time as it is modified or deleted.

You filed a timely protest to our adverse ruling and requested a National Office conference. A conference was held with your representative, [REDACTED], on [REDACTED], by telephone. We have carefully considered the arguments made in your protest and in the conference. Nevertheless, we still conclude that our adverse ruling of [REDACTED], is correct, and for the reasons stated. Accordingly, you are required to file federal income tax returns on the form indicated above.

A copy of this letter will be sent to your key District Director. Please keep this letter with your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown at the top of this letter.

Sincerely your,

Signed [REDACTED]

Chief, Exempt Organizations  
Rulings Branch 1

cc: [REDACTED]  
Attn: EO Group

cc: [REDACTED]

Washington, DC 20224

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date:

OCT 17 1989

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APR 2 1991

Assistant Director Of Internal Revenue  
CHIEF, TECHNICAL STAFF  
BALTIMORE

Employer Identification Number: [REDACTED]

Key District: Baltimore

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax as an organization described in section 501(c)(9) of the Internal Revenue Code. For the reasons stated below, we conclude that you do not qualify for tax exemption under this section. Your protest rights are also explained below.

You were formed pursuant to a Trust Agreement dated [REDACTED], [REDACTED]. Article III states that, "Any sick, accident and other benefits which may be provided under the Plan shall be limited to health and medical benefits, benefits payable to an Employee in lieu of income while unable to work due to sickness or injury, benefits designed to safeguard or to improve the health of Employees, their Dependents and Beneficiaries, and benefits designed to protect against a contingency that interrupts an Employee's earning power."

Article VII, Sec. 7.3, entitled Prohibition Against Diversion of Funds, states in part that, "Notwithstanding any provision of the Plan or Trust to the contrary, it shall be impossible by operation of the Plan or Trustees for any part of the corpus or income of the Trust, or any funds contributed thereto, to inure to the benefit of the Company, any private shareholder, or any individual (other than through the payment of benefits permitted under the Plan), or otherwise to be used for or diverted to purposes other than providing benefits to Employees, their Dependents and Beneficiaries, and defraying reasonable expenses of administering the Plan...."

[REDACTED]

In response to Part III, 2 of Form 1024, exemption application, you list the various hotels which have adopted the Trust. These hotels are located in the following States: [REDACTED] and [REDACTED]. Subsequent to your initial submission, [REDACTED] more hotels have adopted the Trust, including [REDACTED] in [REDACTED].

In a letter dated [REDACTED], from your attorney, [REDACTED], responsive to a development letter from the [REDACTED], the following information is provided in #5:

Two classes of employees have been established for the purposes of providing benefits. The classes are (i) employees of [REDACTED] and (ii) employees of the other adopting employers. The benefits for the two classes are identical except that employees of [REDACTED] are entitled to prescription benefits, dental expense benefits and weekly income benefits.

The "identical" benefits are the self-funded medical benefits. In response #6 of the above letter, [REDACTED] states that employees are required to contribute one-half of the cost of individual coverage and 100% of the cost of family coverage.

In response to Part III, 14 of Form 1024, you state that all employees who work at least thirty (30) hours per week and who make required contributions are eligible to participate in the Plan.

The Summary Plan Description provides the following schedules for the different type benefits:

Schedule of Medical Benefits

Hospitalization or Surgery.....	All Hospital Confinements and Surgical Procedures Are Subject to Authorization By The [REDACTED] Program
Lifetime Maximum.....	\$1,000,000

Basic Benefits

Hospital

Average Semi-Private or  
Intensive Care Room & Board

Extras

Pre-Admission Testing

Inpatient Surgery and Anesthesia

\$5,000 Paid in Full,  
Then Major Medical,  
No Deductible

Outpatient Surgery and Anesthesia.....Paid In Full and MANDATORY  
For Certain Procedures To Be  
Performed On An Outpatient Basis

Second Surgical Opinion.....Paid in Full and MANDATORY  
For Certain Procedures

Major Medical Benefits

Cash Deductible.....\$100/Individual  
\$300 Family

Benefit Percentage.....80% Of The First \$2,500,  
Then 100% To The Maximum

Separate Prescription Benefit

Prescription Card Benefit.....\$2.00 Deductible  
Per Prescription

Schedule of Dental Benefits  
(Management Only)

Annual Maximum.....\$1,000

Dental Deductible.....\$25/Individual  
\$75/Family

Benefit Percentage

Preventive and Basic.....80%

Major and Ortho.....50%

[REDACTED]

Schedule of Weekly Income Benefits  
(Management Only)

Maximum Benefit Period.....26 weeks

Benefit Amount.....70% of Basic Weekly Earnings

BUT NOT TO EXCEED \$300  
MAXIMUM WEEKLY BENEFIT

Benefits Begin.....First Day of Disability For Accident  
Eighth Day of Disability For Illness

The Trust also provides a life insurance benefit. The eligibility requirements are the same as for the medical benefits, i.e., all full-time employees from both [REDACTED] and adopting employers are eligible. This benefit is provided through a contract of insurance with [REDACTED]. The amount of coverage is equal to 150% of basic gross annual earnings rounded to the next \$1,000, not to exceed a maximum of \$110,000.

Section 501(c)(9) of the Code describes a voluntary employees' beneficiary association ("VEBA") providing for the payment of life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and in which no part of its net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a)(2)(i) of the Income Tax Regulations sets forth anti-discrimination rules relating to restrictions on eligibility for membership and benefits. This section states that membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as classification of workers, a minimum period of service, maximum compensation, or full-time employment status. Eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. However, objective criteria may not be selected or administered in a manner that limits membership or benefits to officers, shareholders, or highly compensated employees. Moreover, eligibility for benefits may not be subject to conditions or limitations that have the effect, based on all the facts and circumstances, of entitling members of the prohibited group to benefits that are disproportionate in relation to benefits to which other members of the association are entitled.

Section 1.501(c)(9)-4(b) of the regulations provides that the payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a qualifying benefit for purposes of section 1.501(c)(9)-4(a) notwithstanding that the benefit is of the type permitted by section 1.501(c)(9)-3). Section 1.501(c)(9)-4(b) further provides that generally, benefits paid pursuant to standards or subject to conditions that do not provide for disproportionate benefits to officers, shareholders or highly compensated employees (prohibited group members) will not be considered disproportionate.

We note that while medical benefits and life insurance benefits are provided on an identical basis to employees of both [REDACTED] and the adopting employers, there are other benefits which are available only to the management employees of the sponsoring company. These include dental benefits and short term disability benefits. These restrictions on benefits to the management group, many of whom are prohibited group members, contravenes the anti-discrimination rules set forth in section 1.501(c)(9)-2(a)(2)(i) of the regulations. The payment of disproportionate benefits to management employees by the Trust, without an objective and nondiscriminatory basis, also contravenes the requirements of section 1.501(c)(9)-4(b). The result is that such payments are not made for qualifying benefits within the meaning of Code section 501(c)(9).

Aside from the discrimination problem discussed above, we find another ground for the Trust's disqualification from tax exemption under section 501(c)(9) of the Code. This other ground is the requirement for an employment-related common bond among the participating employees of an organization seeking qualification under section 501(c)(9). We find that the required nexus is not present among the participants in your Trust, as explained below.

In order to qualify as a section 501(c)(9) "employees' association" employee-members must share a special affinity with one another in a manner which constitutes an "employment-related common bond." In this regard, section 1.501(c)(9)-2(a)(1) of the regulations provides that:

"The membership of an organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership in an organization described in section 501(c)(9)

are defined by reference to a common employer (or affiliated employers), to coverage under one or more collective bargaining agreements (with respect to benefits provided by reason of such agreement(s)), to membership in a labor union, or to membership in one or more locals of a national or international labor union. For example, membership in an association might be open to all employees of a particular employer, or to employees in specified job classifications working for certain employers at specified locations and who are entitled to benefits by reason of one or more collective bargaining agreements. In addition, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment-related bond for purposes of an organization through which their employers provide benefits. ... Whether a group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances, taking into account the guidelines set forth in this paragraph." [Emphasis added.]

Our reading of the legislative history of section 501(c)(9) leads us to conclude that multi-employer associations insuring employees of unrelated employees spread over a wide expanse of geographical area were not within the purview of legislative intent.

The history of the regulations under section 501(c)(9) shows that despite requests for deletion of the geographic restriction in the multi-employer context, the provision was retained in the Final Regulations. T.D. 7750 (Preamble), 46 Fed. Reg. 1719 (1981). The stated policies for doing so were (1) that an association conducted to market insurance products to unrelated individuals scattered throughout the country should not be allowed to use section 501(c)(9) as a means to circumvent provisions prescribing the income tax treatment of insurance companies, and (2) that a trade association should not be allowed to use section 501(c)(9) as a means to circumvent the unrelated trade or business income tax on proceeds arising from insurance programs offered to its members.

It is the Service's view that organizations formed by employers within the geographic area of a standard Metropolitan Statistical Area (MSA), a county, a city, a municipality, or a town would generally lack the pertinent insurance attributes and be entitled to exemption under section 501(c)(9). This interpretation both supports stated policy and



ultimately describes and promotes the affinity among employees that is necessary to meet the overall requirement of an "employment-related common bond." Although political lines are significant, it is necessary to examine the facts of each case to fix realistically the limits of a pertinent "geographic locale." For example, a community at the fringe of an MSA may be considered part of the same "geographic locale" of that MSA where facts and circumstances establish a close affinity between the two based on economic, political, or other relevant factors in a manner which assures that the operation of a VERA within such a geographic area would lack any significant degree of proscribed insurance attributes.

Ordinarily, where employers are spread over geographic areas falling within a state but extending beyond those qualifying "locales" designated above (e.g., MSA, county, city, etc.), a determination of whether such areas qualify as "geographic locales" would require a case-by-case examination. For practical administrative reasons, however, the Service has taken the position that a geographic area falling within any given state should be included as a "geographic locale."

Although the restriction of section 1.501(c)(9)-2(a)(1) of the regulations limiting multiple employer trusts to the same geographic locale was ruled invalid in Water Quality Employees' Benefit Corp. v. U. S., 795 F. 2d 1303 (7th Cir. 1986), the Service believes that the holding is in error.

With respect to your own application, the adopting employers span at least [REDACTED] states, in different regions of the country. While all the sponsoring employers are involved in the hotel business, they are not necessarily affiliated employers. Instead, they are either owned in part by [REDACTED] and/or managed by [REDACTED]. Thus, the requirement for an employment-related common bond among participating individuals is not satisfied because the sponsoring employers are not located in the same geographic locale. See section 1.501(c)(9)-2(a)(1) of the regulations and the underlying history of the "same geographic locale" requirement, as discussed above. While the continued need for this particular requirement is under study by the Service, it remains in effect until such time as it is modified or deleted.

Based on the foregoing, we hold that you do not qualify for exemption from federal income tax as an organization described in section 501(c)(9) of the Code. Accordingly, you are required to file federal income tax returns on Form 1041.

[REDACTED]

You have a right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days from the date of this letter, in duplicate, and must be signed by one of your principal officers. When sending a protest or other correspondence with respect to this case, you will expedite its receipt by placing the following symbols on the envelope: [REDACTED].

- These symbols do not refer to your case but rather to its location.

You also have a right to a conference in this office after your protest is submitted. If you desire a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to the District Director, Baltimore, Maryland, which is your key district for exempt organization matters. Thereafter, any questions about your federal income tax returns or the filing of tax returns should be addressed to your key District Director.

Sincerely yours,

Signed [REDACTED]

[REDACTED]  
Chief, Exempt Organizations  
Rulings Branch 1

cc: [REDACTED]  
Attn: EO Group

cc: [REDACTED]

[REDACTED]